

**BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO**

In the Matter of the Protest of	)	DOCKET NO. 17272
	)	
Redacted	)	DECISION
Petitioner.	)	
	)	

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On December 20, 2002, the staff of the Income Tax Audit Bureau of the Idaho State Tax Commission issued a Notice of Deficiency Determination to the Redacted (taxpayer), proposing income tax, penalty, and interest for the taxable year 1998 in the total amount of \$5,072.

On February 21, 2003, the taxpayer filed a timely appeal and petition for redetermination. The taxpayer did not request a hearing but chose to submit additional information for the Tax Commission to consider. The Tax Commission, having reviewed the file, hereby issues its decision.

The Income Tax Audit Bureau (Bureau) received information that showed real property was sold in Idaho by the taxpayer's trustee in 1998. The Bureau researched the Tax Commission's records and found that the sale was not reported to Idaho on any related Idaho income tax return. Idaho Code section 63-3026A(3)(ii) states that income shall be considered derived from or relating to sources within Idaho when such income is attributable to or resulting from the ownership or disposition of any interest in real or tangible personal property located in Idaho.

The Bureau sent the taxpayer's trustee a letter asking her about the sale of the Idaho property and the requirement to file an Idaho income tax return. The taxpayer's accountant responded via telephone saying the taxpayer was part of a complicated series of trusts and only had losses to report. The Bureau continued to correspond with the trustee trying to get

information about the property sale and a return for the taxpayer. The taxpayer's accountant provided a copy of the taxpayer's federal return. The Bureau reviewed the taxpayer's federal return, determined an Idaho return was required and prepared an Idaho income tax return for the taxpayer. The Bureau then sent the taxpayer a Notice of Deficiency Determination, which the taxpayer protested.

The Tax Commission sent the taxpayer a letter giving it two options for having the Notice of Deficiency Determination redetermined. The taxpayer chose to submit additional information for consideration. The Tax Commission reviewed the additional information and the contents of the file.

The taxpayer is a simple trust that was created in 1995. The trust's only apparent connection with Idaho was that it had part ownership in commercial rental property and it owned other real property in Idaho. The trust is also a partner in three partnerships that apparently do not transact business in Idaho.

Idaho Code section 63-3030 states that every trust required to file a federal return, the residence of which is Idaho or in a state other than Idaho and having a gross income from Idaho sources in excess of one hundred dollars, is required to file an Idaho income tax return. IDAPA 35.01.01.035, Income Tax Administrative Rules, defines the residency status of trusts. Subsection .035.01 states that a resident trust meet at least three of the following conditions to be considered an Idaho resident trust.

- 1 – The domicile or residency of the grantor is in Idaho;
- 2 – The trust is governed by Idaho law;
- 3 – The trust has real or tangible personal property located in Idaho;
- 4 – The domicile or residency of a trustee is in Idaho;
- 5 – The administration of the trust takes place in Idaho.

If a trust does not qualify as a resident trust, it is treated as a nonresident trust. A nonresident trust computes its Idaho tax liability in the same manner as a nonresident individual (IDAPA 35.01.01.035.03). If a trust is treated as a nonresident trust, only those items of income, gain, loss and deduction that are derived from or related to sources within Idaho are Idaho source income to the beneficiary (IDAPA 35.01.01.261).

From the information available, the Tax Commission found that the taxpayer was a nonresident trust. The Tax Commission found that the taxpayer met only one of the conditions listed in IDAPA 35.01.01.035.01, having real or tangible personal property in Idaho. Since the taxpayer did not qualify as a resident trust, the taxpayer is deemed a nonresident trust. Therefore, the taxpayer was required to report to Idaho those items of income, gain, loss, and deduction derived from or related to sources within Idaho.

In 1998, the taxpayer sold property located in Redacted. Generally, the beneficiary of the taxpayer is required to report the distributable income on the sale to Idaho. However, in this case, the Tax Commission found no such reporting.

Idaho Code section 63-3022(h) states that in the event a nonresident beneficiary of a trust fails to report all or any part of distributable net income or fails to pay any tax due thereon, the trust shall be taxable upon the amount of such distribution. The taxpayer's beneficiary is Redacted. In 1998, Redacted filed a nonresident income tax return with the state of Idaho. Nothing was reported on Redacted return from the taxpayer. Therefore, since the taxpayer's beneficiary was a nonresident of Idaho and the distributable income was not reported to Idaho on the beneficiary's return, the taxpayer is liable for the tax due on the amount of the distributable income.

The taxpayer argued that it had losses from prior years and the 1998 year to offset the gain on the sale. The taxpayer also stated there was interest expense on the Idaho property that should be allowed. The taxpayer provided documentation to support its position.

The Tax Commission reviewed the documentation the taxpayer provided and found that the prior years' losses were from sources outside of Idaho. Idaho Code section 63-3022(c)(2) states that net operating losses incurred by a trust in activities not taxable by Idaho cannot be subtracted from Idaho taxable income. Therefore, the prior years' losses from sources outside of Idaho cannot be used to offset the gain on the sale of the Idaho property.

As for the 1998 loss, the Tax Commission found that the loss was from Idaho activities but that it was also from a passive activity. Passive activity losses are only allowed against passive activity income per Internal Revenue Code section 469. Since Idaho follows the Internal Revenue Code in the determination of taxable income, the passive activity rules of the Internal Revenue Code are applicable in the determination of Idaho taxable income (Idaho Code section 63-3002). The Idaho Code has no provision to allow passive activity losses in addition to what is already allowed in the federal code. Therefore, no additional 1998 loss is available to offset the capital gain.

The taxpayer also provided documentation showing mortgage interest and property tax paid during 1998. However, the documentation showed the payer as Redacted and reported Redacted social security number as the tax identification number. Therefore, it appears the interest and taxes were not attributable to the taxpayer. The taxpayer and Redacted are separate entities in tax law and are required to make separate

returns of income claiming and receiving their own appropriate deductions. Anderson v. Wilson 289 U.S. 20, 53 S. Ct. 417. If Redacted paid the expenses for the taxpayer, the taxpayer cannot deduct the expenses because it did not pay them.

Furthermore, the documentation provided does not show that it was related to the property sold. The documents have loan reference numbers but no property description or location. Consequently, the Tax Commission could not identify these expenses as being related to the Idaho property. The information provided did not clearly support a deduction against the gain on the sale of the Idaho property.

The return the Bureau prepared for the taxpayer treated the taxpayer as an Idaho resident trust. However, as previously stated, the Tax Commission found that the taxpayer did not qualify as a resident trust. Therefore, the Tax Commission modified the return the Bureau prepared to reflect the nonresident status of the taxpayer.

The Bureau added interest and penalty to the taxpayer's Idaho tax. The Tax Commission reviewed those additions and found them to be appropriate and in accordance with Idaho Code sections 63-3045 and 63-3046.

WHEREFORE, the Notice of Deficiency Determination dated December 20, 2002, is hereby MODIFIED, in accordance with the provisions of this decision and, as so modified, is APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the taxpayer pay the following tax, penalty, and interest:

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
1998	\$3,786	\$ 947	\$1,254	\$5,987

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of the taxpayer's rights to appeal this decision is enclosed with this decision.

DATED this \_\_\_\_ day of \_\_\_\_\_, 2003.

IDAHO STATE TAX COMMISSION

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COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this \_\_\_\_ day of \_\_\_\_\_, 2003, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

Redacted

Redacted

REDACTED